VZCZCXYZ0000
RR RUEHWEB

DE RUEHBU #1279/01 1581314
ZNR UUUUU ZZH
R 071314Z JUN 06
FM AMEMBASSY BUENOS AIRES
TO RUEHC/SECSTATE WASHDC 4803
INFO RUEATRS/DEPT OF TREASURY WASHDC
RUCPDOC/USDOC WASHDC
RUEHRC/USDA FAS WASHDC 2194
RUEHC/DEPT OF LABOR WASHDC
RHMFISS/HQ USSOUTHCOM MIAMI FL

UNCLAS BUENOS AIRES 001279

SIPDIS

SIPDIS

PASS FED BOARD OF GOVERNORS FOR PATRICE ROBITAILLE
TREASURY FOR DAS LEE, RAMIN TOLOUI AND CHRIS KUSHLIS
NSC FOR SUE CRONIN
AND OCC FOR CARLOS HERNANDEZ
USDOC FOR ALEXANDER PEACHER
USDOL FOR ILAB PAULA CHURCH AND ROBERT WHOLEY
USSOUTHCOM FOR POLAD
OPIC FOR GEORGE SCHULTZ AND RUTH ANN NICASTRI

E.O. 12958: N/A
TAGS: EFIN ECON ELAB ALOW AR
SUBJECT: Argentina Economic and Financial Weekly for
the two-week period ending June 2, 2006

-- --------
Weekly Highlights
-- --------

- Technical agreement reached on price of Bolivian gas
exports to Argentina.
- GOA eases meat export ban.
- IMF mission in Argentina for Article IV review.
- April trade surplus of USD 1.3 billion -- above
expectations.
- President Kirchner announces that unemployment
decreased to 10.8 percent in April.
- Argentine provinces at risk of running fiscal
deficit.
- Natural gas supply to industrial customers cut due
to colder weather.
- Commentary of the Week: "The Need for Anti-Cyclical
Policies"

-- --------
Technical agreement on price of Bolivian gas imports
to Argentina.
-- --------

¶1. After numerous delays, the GOA and GOB technical delegations reached a preliminary agreement on a gas price range of USD 4.5-5.5 per million cubic meters imported to Argentina. The presidents of both countries are scheduled to meet the second week of June to agree on the final price, which will be adjustable according to the prices of gas substitutes. Still, many final details of the agreement need to be determined, such as the "the basic price" used for making price adjustments. [Argentina currently imports 5 percent of its gas consumption from Bolivia at a "solidarity" price of USD 3.20 per million cubic meters, while the international price ranges between USD 2.00 and USD 8.00 per million cubic meters.]

-- --------
GOA eases beef export ban.
-- --------

¶2. On May 29, the GOA issued a resolution (N 397)

allowing beef exporters to export 40 percent of the total exports volume between June and November of 2005, which represents 14,000 tons. The GOA measure eases the complete ban on beef export ban for six months that was implemented last March and signals that the GOA will attempt to lift the export ban by gradually increasing the quantity allowed to be exported. The quota will be distributed between 80 wholesalers in proportion to their sales during the mentioned period and is estimated to generate exports revenues of USD 260 million, according to private consultants.

-- --------
IMF mission in Argentina for Article IV review.
-- --------

¶3. On May 29, an IMF mission arrived to Buenos Aires for the Article IV review of Argentina. The mission will mainly review the country's economic, fiscal and financial policy, as well as inflation and state control over the economy. This is the first mission to visit Buenos Aires since the GOA paid its entire debt to the IMF in January. The IMF mission also met with congressmen to express its concerns over money laundering and terrorism finance, and presented a draft of a terrorism finance bill.

-- --------
April trade surplus of USD 1.3 billion -- above expectations.
-- --------

¶4. The April trade surplus reached USD 1.3 billion, above market expectations of USD 1 billion. Growth of both exports and imports decelerated. Exports increased 8 percent y-o-y to USD 3.8 billion, following 16 percent y-o-y growth in March, with increases in both price (+4 percent) and quantity (+4 percent). The stronger-than-expected result came in spite of the GOA meat export ban -- which is estimated to have reduced exports by USD 70 million, according to private consultants -- and smaller corn and wheat crops. Exports were driven by an increase in fuel and energy (+9 percent y-o-y), agro-industrial products (+8 percent y-o-y), industrial goods (+11 percent y-o-y) and primary goods (+3 percent y-o-y). Imports increased 7 percent y-o-y to USD 2.5 billion, decelerating after March's 24 percent y-o-y increase, with increases in both quantity (+5 percent) and price (+2 percent). Imports were driven by increases in accessories for capital goods (+8 percent), passenger vehicles (+47 percent), consumer goods (+22 percent) and capital goods (+24 percent), and decreases in fuel and oil (-28 percent) and in intermediate goods (-5 percent). According to the BCRA consensus survey, the trade surplus is expected to narrow to USD 8.9 billion in 2006 compared to USD 11.3 billion in 2005.

-- --------
President Kirchner announces that unemployment

decreased to 10.8 percent in April.
-- --------

¶5. On May 31, President Kirchner preliminary announced that the unemployment rate decreased to 10.8 percent in April -- compared to 11.4 percent in the first quarter of 2006-- but still higher than the 10.1 percent reported in the fourth quarter of 2005. These unemployment figures exclude participants in the Head-of-Household income supplement plan. Their inclusion would increase the unemployment rate by at least 2 percentage points. The BCRA consensus survey forecasts that unemployment will fall to 9.2 percent at the end of 2006. Unemployment peaked at 24 percent in May 2003.

-- --------
BCRA to measure core inflation.
-- --------

¶6. In a press release dated May 22, the BCRA announced that it is developing a new index to measure core inflation to identify general and persistent price changes but exclude price increases of those goods that have a volatile price trend. The BCRA inflation index will be used for internally to manage monetary policy and will not replace the Indec -- National Bureau of Statistics-- CPI index.

-- --------
AySA to announce investments for ARP 9 billion for the next five years.
-- --------

¶7. AySA (Agua y Saneamientos Argentina S.A.) will present to the GOA a ARP 9 billion five-year investment program for potable water and sewerage works in Buenos Aires province and the city of Buenos Aires. Financing sources for this investment are not yet defined, but according to an AySA representative, alternative financing sources include: the GOA, the Buenos Aires provincial government and credits from IFIs. AySA's own capital contribution will be ARP 150 million.

-- --------
GOA reportedly will delay new bond issuance.
-- --------

¶8. On May 31, Cronista Comercial reported that the GOA will delay the issuance of USD 500 million of the Bonar V bond due to recent international financial market instability, particularly in emerging markets.

The GOA still needs USD 300-500 million to close this year's financial program. However, the GOA may chose to close its financing gap through bond sales to the Government of Venezuela (GOV) or the GOA's fiscal surplus if international capital markets remains unstable. Although 2006 financial schedule is still not closed, the GOA wants to start its 2007 financing program soon, since 2007 is an election year.

-- --------
BCRA rolls over its maturities maintaining interest rates almost unchanged.
-- --------

¶9. The BCRA received ARP 984 million in bids at its May 30 Lebac and Nobac auction, compared to the ARP 559 million in Lebacs that came due during the week. It accepted Lebac bids totaled ARP 401 million representing 60 percent of the total, with Nobac bids accepted for the remaining 40 percent. Short-term Lebacs were withdrawn since the BCRA was not willing to accept the higher interest rates demanded. The yield on the 175-day Lebac increased 11 basis points from 8.25 percent to 8.36 percent, while the yield on the 266-day Lebac decreased slightly from 10.40 percent to 10.38 percent. The yield on the longest term Lebac, the 364-day Lebac, was 11.90 percent. Lebacs for maturities of more than 364 days were withdrawn due to lack of interest. The spread on the one-year Nobac decreased from 2.12 percent to 2.10 percent and for the two-year Nobac from 3.37 percent to 3.35 percent. The Badlar rate (the base rate for Nobacs) is currently at 8.9 percent.

-- --------
Moody's raises its ratings on domestic banks.
-- --------

¶10. On May 31, Moody's rating agency raised its

rating on many domestic banks including Macro Bansud, Patagonia, Suquia, Ciudad de Buenos Aires, Itau, Rio, Frances, Credicoop and Banco de Valores. The upgrade is based on banks' increased incomes, improved quality of banks' assets and decreased exposure to the public sector.

-- --------
Private sector financing increased to 27 percent of GDP in 2005.
-- --------

¶11. Private sector financing increased from ARP 64 billion (17 percent of GDP) in 2003 to ARP 146 billion (27 percent of GDP) in 2005. [Financing to the private sector reached a peak of 52 percent of GDP in 1999.] Bank loans represented 87 percent (of total financing) in 2005 compared to 94 percent in 2003. Other forms of financing including leasing, fiduciary trusts and ADRs increased their participation to the remaining 13 percent in 2005. Private sector financing in pesos reached 87 percent in 2005 -- compared to 13 percent in 2001. In tandem, USD financing participation decreased from 43 percent of the total in 2001 to13 percent in 2005. The shift in currency is mainly explained by GOA pesification in 2002 and expectations about the evolution of the exchange rate, as well as by regulations discouraging financing in foreign currencies.

-- --------
Quasi-Par bond to start trading at the stock exchange.
-- --------

¶12. The Quasi-Par bond -- one of the bonds issued during the GOA debt restructuring-- will start trading at the stock exchange June 2 (one year after its issuance, as established in the debt prospectus). [The Quasi-Par is a 42-year bond adjusted by CER (CPI-linked index), carrying a coupon of 3.31 percent that

is capitalized until 2013.] Trading of this bond is expected to be reduced since AFJPs (private pension funds) hold 90 percent of the issue amount of ARP 24.3 billion, and they are likely to hold onto the Quasi-Pars, as they match their obligation flows. Furthermore, AFJPs have Quasi-Par bonds valued at an average of ARP 93 -- higher than the expected market price of ARP 56-63 -- which would cause funds to recognize a loss if they sell them at market prices. The expected market price of ARP 56-63 implies a yield of 6.5 percent and 7 percent plus CER.

-- --------
Employment index increased 0.6 percent m-o-m in April - according to Ministry of Labor survey.
-- --------

¶13. The Ministry of Labor announced that its employment index increased 0.6 percent m-o-m in March. The construction sector had the highest job creation in March (up 3.1 percent m-o-m), followed by trade and services (up 0.6 percent m-o-m), while job creation in the manufacturing remained stable. The index increased 8.6 percent y-o-y. (The index is based on surveys from the cities of Buenos Aires, Mendoza, Rosario, Cordoba and Tucuman).

-- --------
The World Bank will finance a program to end the Head-of-Households Plans.
-- --------

¶14. The World Bank will finance a USD 3.3 billion program designed to gradually end the Head-of-Households income supplement plans. 1.5 million people now receive benefits under these plans. The program is expected to reduce that to less than a

million over three years. The World Bank believes that these plans were helpful during the crisis, but that they should not be maintained on a permanent basis.

-- --------
Argentine provinces at risk of running fiscal deficit.
-- --------

¶15. The Minister of Economy of Buenos Aires province, Gerardo Otero, admitted that the province's fiscal balance may turn negative in coming months and complained about the disequilibria between GOA resources and provincial expenditures. Private consultants estimated that all provinces combined primary fiscal surplus may drop 41 percent to ARP 2.6 million in 2006 -- compared to ARP 4.4 billion in
¶2005. Provinces are also seeking to restructure their debt, which is owed mainly to the GOA. [Total provincial debt stock currently stands at ARP 60 billion.]

-- --------
Natural gas distributors cut gas supplies to industrial customers due to colder weather.
-- --------

¶16. Natural gas distributors, Metrogas and Gas Natural Ban -- two of the main providers of natural gas in the city of Buenos Aires -- started cutting compressed natural gas supplies to filling stations, industrial clients and power generators (all of which had interruptible contracts) this week due to higher demand during the colder winter season. Residential users are shielded from restrictions. Gas restrictions and shortages to customers started in 2004, and since then compressed gas stations and industries have been increasingly forced to sign interruptible contracts.

-- --------
May Government Confidence Index down 2 percent m-o-m -

- second consecutive decrease.
-- --------

¶17. The Government Confidence Index decreased 2 percent m-o-m in May to 2.50 points, 0.10 below the average during the Kirchner administration, but still well above the 1.2 point reading in May 2003 when President Kirchner took office. Confidence in the GOA's ability to solve citizens' problems is still the factor generating the most confidence, remaining the same as in April. Public opinion of the GOA's general performance also remains flat m-o-m, honesty of GOA officials and efficiency of public spending decreased 10 percent and 3 percent m-o-m, respectively. The index rose 5 percent y-o-y. [The Government Confidence Index is a survey-based index prepared by Di Tella University. It varies from zero to five points and seeks to measure public opinion of GOA's general performance, efficiency of pubic spending, honesty of GOA officials and the government's ability to solve problems.]

-- --------
Tourism increased 63 percent y-o-y in the first quater of 2006.
-- --------

¶18. The National Bureau of Statistics (INDEC) announced that net tourism (incoming minus outgoing tourists) increased 63 percent y-o-y to 265,000 in the first quarter of 2006, as a result of the number of incoming tourists increasing to 560,000 (up 22 percent q-o-q) while the number of outgoing tourists remaining nearly unchanged at 295,000. The increase in incoming

tourism is mainly explained by a 38 percent increase in individuals coming to spend their holidays (68 percent of the total). Preferred destinations include the city of Buenos Aires, the Atlantic cost and Cordoba Province, chosen by 42 percent, 8 percent and 6 percent of tourists, respectively. Visiting tourists were mainly from the European Union (32 percent), followed by U.S. and Canada (19 percent) and the rest of Latin America (14 percent).

--- --------
Construction sector incentives signal continuous growth in the sector.
--- --------

¶19. The Q ratio -- measuring the average price of new properties over the construction cost -- calculated by UADE (Universidad Argentina de la Empresa) increased 0.4 points q-o-q to 2.9 points in the first quarter of ¶2006. This means that the average value of the new properties is nearly three times the cost of construction, creating large incentives to invest in the construction sector. Buildings construction increased 13 percent q-o-q and square meters permits (for new construction) increased 75 percent q-o-q in Q1 2006. The construction sector index has grown for thirteen consecutives quarters since the beginning of ¶2003.

--- --------
Banks have excess liquidity to lend.
--- --------

¶20. Banks have nearly ARP 9 billion available to lend, according to private consultants. However, credit demand cannot be fulfilled due to customers' failure to meet credit rating requirements. The financial system liquidity ratio -- cash in banks, banks' deposits at the BCRA and engaged in repo transactions with the BCRA -- is 22.5 percent compared to 21 percent one month ago, and it has increased 3.4 percent so far in 2006.

--- --------
The peso depreciated 1 percent against the USD in the

last two weeks, closing at 3.10 ARP/USD.
--- --------

¶21. The peso depreciated 1 percent versus the USD during the last two weeks, closing at 3.10 ARP/USD. The peso's depreciation is attributed to higher private investors' demand for dollars as a result of the contagion effect from international markets. The BCRA even sold dollars in the FX market to avoid a larger depreciation of the peso. However, the BCRA intervention during the last two weeks reached net purchases of USD 77 million. The peso exchange rate has depreciated 1.6 percent since the beginning of the calendar year.

--- --------
Commentary of the Week: "The Need for Anti-Cyclical Policies", by Martn Redrado, President of the Central Bank of Argentina. (Note: Translated from an article published May 11 in La Nacin. End Note.)
--- --------

¶22. The financial world - as much in the academic sphere as in the professional - dedicates much of its time to trying to identify the origin of the next crisis. The global economy shows a growth that is more balanced geographically, with inflationary pressures that appear to be contained in the short term. In this framework, Latin America - which today is more sensitive to China, India, or Russia's demand for raw materials than to changes in international interest rates - finds itself in a solid financial position

with sustained growth and twin surpluses (fiscal and trade) strengthened by consistent and prudent monetary policies. In the midst of this opportunity, we don't appear on the radar as an epicenter of an eventual global collapse.

¶23. Even though the focus of uncertainty is constrained today, demand pressures on available capacity have already begun to appear. The greatest risks are concentrated in structural vulnerabilities, such as the growing global inequalities between the United States, the Asian-Pacific region and continental Europe. In this respect, the likelihood that less favorable conditions will materialize requires that countries like Argentina implement anti-cyclical macroeconomic policies -- including the accumuation of international reserves, fiscal savings, and a regulatory environment that permits the establishment of solid financial systems -- that are capable of lessening the potential impacts on internal variables and of preserving sustainable growth.

¶24. The Central Bank provides real anti-crisis security through its policy of increasing reserves, which acts as a guarantee in the face of our recurrent vulnerability to external events. More than ever, we live in a world that is experimenting with a change of focus in international financial rules, one in which the old paradigm is being strongly questioned. Given the absence of a lender of last resort and the still incomplete redefining of the global financial architecture, international reserves should be thought of as a real guarantee against these risks. In other words: in the modern world, there is no good substitute for a healthy policy of internal liquidity, and self-insurance is the only way to achieve this. One asks, then, does this anti-cyclical policy have an expansionary impact on monetary stability? Simply put, no. This impact does not occur because the "other face" of reserve accumulation is the absorption of the money supply that exceeds the demand for money in the economy. This sterilization program consists of three elements: a financial system that pays off its debts early, a public sector that saves, and a Central Bank with a strong balance sheet. These factors reflect the depth and, above all, the unusual quality of the sterilization strategy: there is no expansion of internal credit through monetization of the fiscal deficit or assistance to the financial system as in past decades.

¶25. We implement a strong restrictive policy of monetary absorption through a battery of instruments such as the placement of bonds in the market, the cancellation of discount window lending, repurchase agreement operations and open market operations with a portfolio of public securities. In effect, the anticipated repayment of discount window lending that was granted during the crisis was one of the principal factors in the contraction of the money supply during the past twelve months. Since the beginning of last year, we have created new instruments for the pre-payment of this liquidity assistance. These healthy and unique operations represent repayments on the order of ARP 9.5 billion in 2005 and ARP 5.7 billion so far in 2006, reflecting the improvement in the balance sheets of financial entities and the monetary authority's concern for banks' balance sheets

¶26. At the same time, we have eliminated the possibility of excessive monetary supply through the net issuance of market securities that established reference interest rates, and the issuance of Notes and Bills at fixed and variable rates, that have produced a lengthening of the maturity of the Central Bank liabilities. This policy of absorption has been possible thanks to a renovated financial system and

the strength of the Central Bank's balance sheet, which show earnings greater than ARP 2 billion.

¶27. This policy of sterilization has permitted us to keep the money supply under strict control, which has been reflected in the fulfillment, quarter after quarter, of our self-imposed targets for the growth of monetary aggregates. In our Monetary Program - presented every year to the Senate - we make projections based on the different factors that determine money supply. Based on the interaction between supply and demand for money, we project the need for sterilization, as required for the expected development of the main instruments of monetary regulation.

¶28. Further, the Central Bank is building a monetary-financial system that, for the first time in decades, will be independent of the financial needs of the public sector. To do this, we have set guidelines that determine the specific limits for the exposure of the financial system to the national, provincial and municipal public sectors. First, maximum limits have been established depending on the capital of each financial entity and on the type of debt (e.g. from national, provincial or municipal government) held in the portfolio. Second, we have set a total maximum limit of 40 percent of banks' total assets, which went into effect at the beginning of this year. In this way, we are reversing at an accelerated pace the crowding out of private credit in favor of public sector financing that occurred in past decades. In the last twelve months, public debt's share in banks' portfolios decreased ten percentage points, reaching a level of 28 percent. Credits to businesses and families, on the other hand, grew nearly 38 percent during the same period. This trend has been significant in terms of giving additional degrees of freedom for monetary policy and the financial system. This factor is crucial, in Argentina as well as in Latin America, where excessive financing of the government historically has been ignored when evaluating the independence of central banks.

¶29. The challenge lies, then, in consolidating the continuation of these policies, given that their depth and quality is as relevant as their stability over time. The challenges that we face are not sequential but simultaneous: to grow and create lasting policies

that guarantee sustained economic growth with social inclusion in a framework of permanent monetary and financial stability. (Note: We reproduce selected articles by local experts for the benefit of our readers. The opinions expressed are those of the authors, not of the Embassy. End Note.)

GUTIERREZ